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**REPORT OF THE AUDIT OF THE
KNOTT COUNTY
SHERIFF'S SETTLEMENT
2005 UNMINED COAL TAXES**

August 31, 2006

**Member Kentucky Society of CPA's
American Institute of Certified Public Accountants**

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To The People of Kentucky
Honorable Ernie Fletcher, Governor
John R. Farris, Secretary
Finance and Administration Cabinet
Honorable Randy Thompson, Knott County Judge/Executive
Honorable Ray E. Bolen, Knott County Sheriff
Members of the Knott County Fiscal Court

Independent Auditor's Report

I have audited the Knott County Sheriff's Settlement - 2005 Unmined Coal Taxes as of August 31, 2006. This tax settlement is the responsibility of the Knott County Sheriff. My responsibility is to express an opinion on the financial statement based on my audit.

I conducted my audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in the Government Auditing Standards issued by the Comptroller General of the United States, and the Audit Guide for Sheriff's Tax Settlements issued by the Auditor of Public Accounts, Commonwealth of Kentucky. Those standards require that I plan and perform the audit to obtain reasonable assurance about whether the financial statement is free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statement. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. I believe that my audit provides a reasonable basis for my opinion.

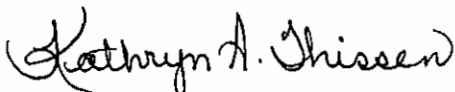
As described in Note 1, the Sheriff's office prepares the financial statement on a prescribed basis of accounting that demonstrates compliance with the modified cash basis, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

In my opinion, the accompanying financial statement referred to above presents fairly, in all material respects, the Knott County Sheriff's taxes charged, credited, and paid as of August 31, 2006, in conformity with the modified cash basis of accounting.

In accordance with Government Auditing Standards, I have also issued my report dated January 18, 2007, on my consideration of the Sheriff's internal control over financial reporting and on my tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of my testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of my audit.

Based on the results of my audit, I have presented the accompanying comment and recommendation, included herein, which discusses the following reportable condition and material weakness:

- Sheriff's Office Lacks An Adequate Segregation Of Duties



Kathryn A. Thissen
Certified Public Accountant

January 18, 2007

KNOTT COUNTY
RAY E. BOLEN, SHERIFF
SHERIFF'S SETTLEMENT - 2005 UNMINED COAL TAXES

August 31, 2006

<u>Charges</u>	<u>County Taxes</u>	<u>Special Taxing Districts</u>	<u>School Taxes</u>	<u>State Taxes</u>
Unmined Coal 2005 Property Tax	\$ 139,109	\$ 98,997	\$ 505,850	\$ 184,073
Increase Through Exoneration	60	40	219	80
Penalties	286	284	1040	379
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Gross Chargeable to Sheriff	\$ 139,455	\$ 99,321	\$ 507,109	\$ 184,532
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
<u>Credits</u>				
Discounts	\$ 2,488	\$ 1,716	\$ 9,045	\$ 3,291
Exonerations	414	318	1,507	548
Delinquent Unmined Coal	1,065	723	3,873	1,410
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total Credits	\$ 3,967	\$ 2,757	\$ 14,425	\$ 5,249
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Net Tax Yield	\$ 135,488	\$ 96,564	\$ 492,684	\$ 179,283
Less: Commissions *	5,758	4,104	19,707	7,620
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Net Taxes Due	\$ 129,730	\$ 92,460	\$ 472,977	\$ 171,663
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Taxes Paid	129,726	92,457	472,963	171,658
Refunds (Current and Prior Year)	4	3	14	5
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Due District or (Refund Due Sheriff) as of Completion of Fieldwork	\$ 0	\$ 0	\$ 0	\$ 0
	<u> </u>	<u> </u>	<u> </u>	<u> </u>

* Commissions:
4.25% on 411,335
4% on 492,684

The accompanying notes are an integral part of the financial statement.

KNOTT COUNTY
NOTES TO FINANCIAL STATEMENT

August 31, 2006

Note 1. Summary of Significant Accounting Policies

A. Fund Accounting

The Sheriff's office tax collection duties are limited to acting as an agent for assessed property owners and taxing districts. A fund is used to account for the collection and distribution of taxes. A fund is a separate accounting entity with a self-balancing set of accounts. Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions or activities.

B. Basis of Accounting

The financial statement has been prepared on a modified cash basis of accounting. Basis of accounting refers to when charges, credits, and taxes paid are reported in the settlement statement. It relates to the timing of measurements regardless of the measurement focus.

Charges are sources of revenue which are recognized in the tax period in which they become available and measurable. Credits are reductions of revenue which are recognized when there is proper authorization. Taxes paid are uses of revenue which are recognized when distributions are made to the taxing districts and others.

C. Cash and Investments

At the direction of the fiscal court, KRS 66.480 authorizes the Sheriff's office to invest in the following, including but not limited to, obligations of the United States and of its agencies and instrumentalities, obligations and contracts for future delivery or purchase of obligations backed by the full faith and credit of the United States, obligations of any corporation of the United States government, bonds or certificates of indebtedness of this state, and certificates of deposit issued by or other interest-bearing accounts of any bank or savings and loan institution which are insured by the Federal Deposit Insurance Corporation (FDIC) or which are collateralized, to the extent uninsured, by any obligation permitted by KRS 41.240(4).

Note 2. Deposits

The Sheriff maintained deposits of public funds with depository institutions insured by the Federal Deposit Insurance Corporation (FDIC) as required by KRS 66.480(1)(d). According to KRS 41.240(4), the depository institution should pledge or provide sufficient collateral which, together with FDIC insurance, equals or exceeds the amount of public funds on deposit at all times. In order to be valid against the FDIC in the event of failure or insolvency of the depository institution, this pledge or provision of collateral should be evidenced by an agreement between the Sheriff and the depository institution, signed by both parties, that is (a) in writing, (b) approved by the board of directors of the depository institution or its loan committee, which approval must be reflected in the minutes of the board or committee, and (c) an official record of the depository institution.

KNOTT COUNTY
NOTES TO FINANCIAL STATEMENT
August 31, 2006
(Continued)

Note 2. Deposits (Continued)

Custodial Credit Risk – Deposits

Custodial credit risk is the risk that in the event of a depository institution failure, the Sheriff's deposits may not be returned. The Sheriff does not have a deposit policy for custodial risk but rather follows the requirements of KRS 41.240(4). As of August 31, 2006, all deposits were covered by FDIC insurance or a properly executed collateral security agreement.

Note 3. Tax Collection Period

The Unmined coal tax assessments were levied as of January 1, 2005. Property taxes were billed to finance governmental services. Liens are effective when the tax bills become delinquent. The collection period for these assessments was April 25, 2006 through August 31, 2006.

Note 4. Interest Income

The Knott County Sheriff earned \$240 as interest income on 2005 unmined coal taxes. The Sheriff distributed the appropriate amount to the school district as required by statute, and the remainder was used to operate the Sheriff's office.

Note 5. Sheriff's 10% Add-On Fee

The Knott County Sheriff collected \$2,157 of 10% add-on fees allowed by KRS 134.430(3). This amount will be used to operate the Sheriff's office.

Note 6. Advertising Costs And Fees

The Knott County Sheriff collected \$175 of advertising costs and \$485 of advertising fees allowed by KRS 424.330(1) and KRS 134.440(2). The Sheriff distributed the advertising costs to the county as required by statute, and the advertising fees will be used to operate the Sheriff's office.

COMMENT AND RECOMMENDATION

KNOTT COUNTY
RAY E. BOLEN, SHERIFF
COMMENT AND RECOMMENDATION

As of August 31, 2006

STATE LAWS AND REGULATIONS:

None.

INTERNAL CONTROL – REPORTABLE CONDITION AND MATERIAL WEAKNESS:

Sheriff's Office Lacks An Adequate Segregation Of Duties

I noted the lack of an adequate segregation of duties for the internal control structure and its operation that, in my judgment, is a reportable condition. Management has considered and rejected additional cost when setting budget limits on spending for salaries and therefore accepts the degree of risk for a lack of an adequate segregation of duties. However, the lack of an adequate segregation of duties is hereby noted as a reportable condition and a material weakness pursuant to professional auditing standards.

Auditor discussed recommendations with the Sheriff relating to compensating controls to help offset the lack of segregation of duties which included the following:

- Cash recounted and deposited by the official
- Surprise cash counts by the official
- Agree monthly tax reports to revenue and expenditure ledgers
- Agree daily tax collection totals to revenue ledger and deposit slip
- Official delivers tax distribution checks and monthly tax reports to taxing districts and receives a signed receipt documenting delivery

Sheriff's Response:

Sheriff agreed to the above recommendations and will try to implement some of them to try to offset the lack of segregation of duties.

PRIOR YEAR:

- Sheriff's Office Lacks An Adequate Segregation Of Duties

This comment has not been corrected and is repeated in the current year audit.

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND
ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF THE FINANCIAL
STATEMENT PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Kathryn A. Thissen
Certified Public Accountant

The Honorable Randy Thompson, Knott County Judge/Executive
Honorable Ray E. Bolen, Knott County Sheriff
Members of the Knott County Fiscal Court

Report On Internal Control Over Financial Reporting And On Compliance
And Other Matters Based On An Audit Of The Financial
Statement Performed In Accordance With Government Auditing Standards

I have audited the Knott County Sheriff's Settlement - 2005 Unmined Coal Taxes as of August 31, 2006, and have issued my report thereon dated January 18, 2007. The Sheriff's financial statement is prepared in accordance with a basis of accounting other than generally accepted accounting principles. I conducted my audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing my audit, I considered the Knott County Sheriff's internal control over financial reporting in order to determine my auditing procedures for the purpose of expressing my opinion on the financial statement and not to provide an opinion on the internal control over financial reporting. However, I noted a certain matter involving the internal control over financial reporting and its operation that I consider to be a reportable condition. Reportable conditions involve matters coming to my attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in my judgment, could adversely affect the Knott County Sheriff's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statement. The reportable condition is described in the accompanying comment and recommendation.

- Sheriff's Office Lacks An Adequate Segregation Of Duties

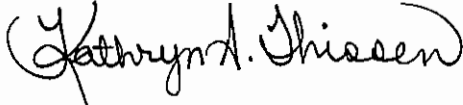
A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statement being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. My consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, I believe that the reportable condition described above is a material weakness.

Compliance And Other Matters

As part of obtaining reasonable assurance about whether the Knott County Sheriff's Settlement - 2005 Unmined Coal Taxes as of August 31, 2006 is free of material misstatement, I performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of my audit and, accordingly, I do not express such an opinion. The results of my tests disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

Report On Internal Control Over Financial Reporting And On Compliance
And Other Matters Based On An Audit Of The Financial Statement
Performed In Accordance With Government Auditing Standards
(Continued)

This report is intended solely for the information and use of management and the Kentucky Governor's Office for Local Development and is not intended to be and should not be used by anyone other than the specified parties.

A handwritten signature in black ink, reading "Kathryn A. Thissen". The signature is written in a cursive style with a large, stylized "K" and "T".

Kathryn A. Thissen
Certified Public Accountant

January 18, 2007